Detailed Analysis of the Paycheck Protection Program

The Coronavirus Aid, Relief and Economic Security Act (CARES Act) includes Title 1, (the Keeping American Workers Paid and Employed Act), which adds a new program (the Paycheck Protection Program, or PPP) to Section 7(a) of the Small Business Act of 1953, as amended (the Small Business Act).

The PPP is administered by the Small Business Administration (SBA). The legislation modifies certain existing limitations on SBA's current 7(a) loan program while also providing an unprecedented expansion of the scope of the program—with an additional $349 billion in available funding over the next three months for a program that traditionally has funded approximately $20-25 billion per year.

Below is a supplement to our alert providing an overview of the PPP. The following information is a more fulsome summary and analysis of the relevant provisions of the PPP provisions of the CARES Act. The provisions of the PPP will be further clarified by regulations to be promulgated by the SBA within 15 days of the enactment of the CARES Act (or by April 11, 2020).

This should not be construed as legal advice. Please consult your professional advisor for specific questions related to your business.

ELIGIBLE BORROWERS

Covered small businesses are small business concerns (as defined pursuant to the Small Business Act) that have experienced certain disruptions as a result of COVID-19. The disruptions include:

- Supply chain disruptions.
- Staffing challenges.
- Decrease in sales or customers.
- Closure.

In addition, any business concern, nonprofit organization, or veterans organization is eligible to receive a covered loan if it has no more than

(a) 500 employees (full-time equivalents) or

(b) meets the size standard for its applicable industry under existing SBA regulations.

Certain specific businesses that are excluded from the 7(a) loan program will continue to be excluded under SBA regulations. **ESOPs are eligible for loans under the SBA 7(a) program.** Small businesses are not excluded if they have reorganized or furloughed or laid off employees.

Changes in their work force may have implications for their loans, but small businesses are not precluded simply because they have already taken actions that have reduced payroll levels.

Small businesses with less than 500 employees (or that meet the applicable employee count for the relevant North American Industry Classification System, or NAICS) code are eligible for the PPP. For this purpose, employees are counted on a full-time equivalent basis. This eligibility determination will be made by including the employees of affiliated businesses in the calculation. Separate employee count rules apply to certain restaurant, foodservice, caterers, and hotels (NAICS codes beginning with 72) that do not employ more than 500 employees per location (even if they employ more than 500 employees in the aggregate).

Businesses with more than one physical location can count employees at each location separately so long as the business concern is assigned a NAICS code that begins with 72 (covering the accommodation and food services industries—over 900,000 businesses) at the time of disbursal. This will provide enhanced benefits to restaurants, hotels, and similar eligible businesses that employ significant numbers of employees in each of multiple locations.

Affiliation rules that typically apply pursuant to existing SBA regulation to loans to businesses under common control will not apply to covered loans to businesses that meet one or more of the following criteria:

- Have not more than 500 employees and an NAICS code beginning with 72.
- That are franchises operating under a franchise identifier assigned by SBA.
- That received financial assistance from a small business investment company (SBIC) licensed by the SBA.

The affiliation rules make eligibility for private equity and venture capital sponsored businesses more complicated and **are expected to continue to cause some of those businesses to be ineligible as a result of private equity ownership**.

The PPP provides for a 100 percent guarantee provided by SBA for any covered loan extended under the PPP during the covered period for making the PPP loans. The "covered period" for the PPP began on February 15, 2020 and extends to June 30, 2020.

SBA has 15 days after the date on which the covered loan is made to register the loan using the TIN assigned to the borrower.

Individuals operating sole proprietorships or as independent contractors and eligible self-employed individuals are eligible to receive covered loans, subject to submission of required documentation.

MAXIMUM COVERED LOAN AMOUNT

The maximum loan amount available to an eligible small business under the PPP is the lesser of:

- Two-and-one-half month's average payroll, or
- $10 million.

The basic calculation is the lesser of:

- Average total monthly payroll costs during the one-year period before the date the loan is funded, multiplied by 2.5 (with certain exceptions for seasonal businesses and businesses that were not in business during the period February 15, 2019 to June 30, 2019), or
- $10 million.

The "payroll costs" for this purpose are:

- Salary, wage, commission, or similar compensation.
- Payment of cash, tips, or equivalents.
- Payment for vacation, parental, family, medical, or sick leave.
- Allowance for dismissal or separation.
- Payment required for the provision of group health care benefits, including insurance premiums.
- Payment of any retirement benefits, or
- Payment of state and local tax assessed on compensation of employees.

The payroll costs calculation excludes:

- The compensation of an individual employee in excess of an annual salary of $100,000.
- Certain employment taxes imposed or withheld under the Internal Revenue Code during the covered period
- Any compensation of an employee whose principal place of residence is outside the United States.
- Qualified sick leave wages or qualified family leave wages, in each case for which a tax credit is allowed under the Families First Coronavirus Response Act.

USE OF COVERED LOANS; GUARANTEES AND COLLATERAL; CERTIFICATIONS BY BORROWERS

Small businesses (and their lenders and equity sponsors) should carefully consider the permitted use of proceeds in conjunction with the provisions for forgiveness to ensure that they are able to take advantage of the benefit of forgiveness to the fullest extent possible. The amount of forgiveness is closely tied to using the proceeds of a covered loan to retain and maintain compensation to employees.

In addition to the allowable uses of a loan under existing SBA regulations (which typically are focused on business expansion and acquisition of capital goods), proceeds of covered loans may be used for:

- Payroll costs (as defined above).

- Costs related to continuation of group health care benefits during periods of paid sick, medical, or family leave and insurance premiums.
- Employee salaries, commissions, or similar compensations.
- Mortgage payments.
- Rent.
- Utilities.
- Interest on any other debt incurred before the covered period for the PPP loan.

Principals of borrowers will not be required to provide personal guarantees, and the borrowers will not be required to provide collateral.

Borrowers may simultaneously hold an economic injury disaster loan and a covered loan if the economic injury disaster loan was made between January 31, 2020 and the date on which covered loans are made available (which was March 27, 2020) where the economic injury disaster loan was extended for purposes other than paying payroll of the other permitted purposes for covered loans. In addition, economic injury disaster loans made during the required time frame may be refinanced with the proceeds of a covered loan.

A recipient of a covered loan must make a good faith certification that:

- Uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient.
- Acknowledging that funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments (note that these uses are not an exact overlap with the permitted uses of the loan as reflected above).
- Recipient does not have an application pending for another loan for the same purpose and duplicative of amounts applied for or received under a covered loan—an eligible borrower cannot apply for or obtain or have an economic injury disaster loan after the date of enactment of the PPP and have a covered loan outstanding at the same time.
- During the period beginning February 15, 2020 and ending December 31, 2020, the recipient has not received amounts under section 7(a) for the same purpose and duplicative of amounts applied for or received under the covered loans.

FORGIVENESS

One of the primary benefits of the PPP is that borrowers may be able to attain forgiveness of all or a portion of the covered loan by demonstrating that the loan was used for certain permitted purposes. Borrowers should plan for and accumulate documentation demonstrating the relevant expenses to achieve the greatest forgiveness that they can achieve.

A recipient will be eligible for forgiveness of the principal amount of a covered loan to the extent the borrower has incurred and paid the following during the covered period, which is the eight-week period beginning on the date of the origination of the covered loan:

- Payroll costs (as defined above).
- Any payment of interest on any covered mortgage obligation.
- Any payment on any covered rent obligations.
- Any covered utility payment.

Note that this list of permitted uses for purposes of forgiveness does not completely overlap the permitted uses of loan proceeds set forth above. To achieve forgiveness, borrowers will need to provide adequate required documentation to their lender evidencing the payment of permitted expenses.

A borrower with tipped employees may receive forgiveness for additional wages paid to those employees.

Forgiveness of the principal balance of a covered loan will be reduced by multiplying the amount of the covered loan subject to forgiveness (as set forth above) by:

- The average number of full-time equivalent employees per month employed during the covered period, divided by
- The average number of full-time equivalent employees per month employed during the period (as elected by the borrower) (i) February 15, 2019 through June 30, 2019 or (ii) January 1, 2020 through February 20, 2020 (with certain exceptions for seasonal employers).

The amount of loan forgiveness will be reduced by the amount of any reduction in total salary or wages of any employee (who received, during any single pay period during 2019, wages or salary at an annualized rate of pay in an amount more than $100,000) during the covered period that is in excess of 25 percent of the total salary or wages of the employee during the most recent full quarter during which the employee was employed before the covered period.

Rehired employees or employees whose reduced salaries are reinstated will not be considered in determining reductions in forgiveness to the extent that those terminations or salary reductions during the period from February 15, 2020 and the date that is 30 days after the date of enactment of the PPP (or April 26, 2020) are rehired or reinstated not later than June 30, 2020.

Any amount that is forgiven will be excluded from gross income of the borrower. Forgiveness will not otherwise modify the terms and conditions of the covered loan. Amounts forgiven will be considered cancelled indebtedness by the lender. Forgiven loans will be purchased by SBA in accordance with existing guarantee procedures with remittance within 90 days after the determination of forgiveness.

The SBA must promulgate regulations regarding the provisions of forgiveness within 30 days of enactment of the CARES Act (or April 26, 2020).

UNDERWRITING COVERED LOANS; LENDER REGULATORY CONSIDERATIONS; FEES PAID BY SBA

SBA will use its presently authorized 7(a) lenders (banks and non-bank financial institutions) to make loans under the PPP. There are currently in excess of 3,000 authorized lenders. SBA is expected to expand authority to make loans to include additional lenders that have necessary qualifications to process, close, disburse, and service loans to be guaranteed under the PPP. Lenders will have full delegated authority from the SBA to underwrite and make the covered loans.

Lenders will be responsible for evaluating a borrower's eligibility for a covered loan including establishing that the small business:

- Was in operation on February 15, 2020 and
- Had employees for whom the borrower paid salaries and payroll taxes or paid independent contractors as reported on forms 1099.

Fees typically applicable to 7(a) loans will be waived for loans under the PPP. Likewise, the obligation that a small business be unable to obtain "credit elsewhere" is also waived during the covered period.

For bank regulatory purposes, covered loans will receive a risk weight of zero percent. Insured depository institutions and insured credit unions involved in modifications of covered loans in relation to COVID-19-related restructurings on or after March 13, 2020 will not be required to immediately comply with certain accounting standards with respect to troubled debt restructurings.

SBA will reimburse authorized lenders within five days after disbursement of the covered loan:

- Five percent of the loan amount for loans up to $350,000.
- Three percent of the loan amount for loans more than $350,000 but less than $2 million.
- One percent of the loan amount for loans of not less than $2 million (up to $10 million).

Covered loans will be eligible for sale on the secondary market consistent with existing practice once forgiveness, if any, is complete.

REPAYMENT OF LOANS UNDER THE PPP

To the extent not forgiven, principal on any covered loans will have a maximum maturity of 10 years.

Covered loans will bear interest at a rate not to exceed four percent (4.0%) per annum.

During the covered period, lenders will be required to provide in the loan documents for complete payment deferment relief on covered loans for a period of not less than six months and not more than one year. SBA has not more than 30 days to promulgate guidance on the deferment process.

Covered loans will be eligible for sale on the secondary market consistent with existing practice.

Covered loans may be repaid at any time without prepayment penalty. Eligible recipients of a covered loan for purposes of paying payroll costs and other obligations shall not be eligible to receive an economic injury disaster loan from the SBA after March 27, 2020.

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